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# Devine Entertainment Corporation

ANNUAL REPORT 1997



DEVINE ENTERTAINMENT  
CORPORATION



## CONTENTS

1	Profile
2	Letter to Shareholders
4	Program Library
7	Management's Discussion and Analysis of Financial Condition and Results of Operations
10	Consolidated Financial Statements
21	Corporate and Shareholder Information

# Devine Entertainment

is committed to producing the highest quality live-action children's and family television programs and to distributing them to audiences worldwide. We plan to grow by expanding our existing business and by developing new entertainment products and markets around the globe.

### *Devine Entertainment is dedicated to:*

- ★ Building up our "brand" of high quality, live-action children's and family programs
- ★ Consistently building our library of classic films
- ★ Capitalizing on new opportunities in the evolving children's markets worldwide
- ★ Expanding our market reach
- ★ Continuing to work with the best talent to be found



# Devine Entertainment Corporation

## OUTLOOK FOR 1998



The Company has successfully completed the production of *The Inventors' Specials* series and delivered the sixth and final episode, *Edison: The Wizard of Light* in the first quarter of 1998.

By continuing to focus on its own original proprietary production for children and families, the Company is now in pre-production of its next series, *The Artists' Specials*, that focuses on a child's-eye view of the world's great artists. The Company expects to deliver the first two of *The Artists' Specials* in fiscal 1998, with the remaining four films to be delivered in fiscal 1999. *The Artists' Specials* bring to nineteen the total of films that Devine Entertainment has sold to HBO in the U.S. and ensures that the Company's films will be broadcast in its major market well into the new millennium.

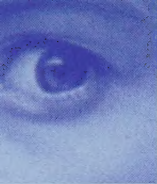
The Company is committed to increasing the growth of its production revenues by increasing the rate of its production activities in the years to come. Accordingly, the Company's available resources can limit the number of proprietary series upon which the Company can commence production at any one time. At year end (December 31, 1997) the Company had over \$1 million in project financing available from contracts for its current productions that are in excess of costs estimated to complete production as well as \$527,506 in cash and term deposits.

Devine Entertainment continues to pursue optimizing its long term revenue potential by owning and retaining control of its products' distribution and focusing on the creation of new products based on its library. The Company looks forward to capitalizing on new strategic alliances with Hal Leonard Corporation in specialty market distribution and with Bell Canada and The Stentor Group of telecommunications companies in creating teacher's guides, educational multimedia and CD-ROM programs in the future. The Company is also committed to building a dedicated sales and marketing force to maximize the value of its growing library of products.

As it maintains its focus on building its proprietary library of original family films, maximizing the revenue from the exploitation of its programs worldwide and developing new products based on its library, management believes that the Company's value will continue to grow.







# Profile

①  
#115

Devine Entertainment Corporation is a fully integrated developer and producer of award-winning family films. The Company's films target the rapidly growing television and home video markets.

The Company's library presently contains 15 original films and 12 CDs.

The Company's focus is the production of films based on historical and timeless stories. This strategy follows the success of our Raffi Concert videos (with sales of over 1 million units to date) and the *Beethoven Lives Upstairs* film. These videos have won over 30 awards, including the 1993 Primetime EMMY Award for *Beethoven Lives Upstairs*. The highly acclaimed *Composers' Specials* series was completed in 1995 and aired on Home Box Office in the United States. The series is both entertaining and educational while inviting children to explore the world.

The Company has continued to build its library of classic films with the production of six films in its new series entitled *The Inventor's Specials*, produced for HBO in 1996 and 1997.

In 1998 and 1999, the Company will be producing another six films for HBO entitled *The Artists' Specials*.

Devine Entertainment programs are currently airing in over 50 countries around the world. The Company has worldwide distribution agreements for its home video products with SONY CLASSICAL and worldwide distribution agreements for its audio products (CDs and cassettes) with SONY MUSIC INTERNATIONAL. The Company's Raffi film was first licensed to the Disney Channel and presently airs on PBS in the United States. *Beethoven Lives Upstairs*, *The Composers' Specials*, *The Inventors' Specials* and our new *Artists' Specials* have all been HBO original programming in the United States.

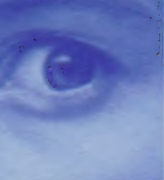
Devine Entertainment is embarking upon the development of new products including CD-ROMs and teacher guides. The Company's goal is to expand its own integrated distribution activities in non-traditional, educational and direct markets internationally.

The Company is headquartered in Toronto employing eight full-time people and up to 150 persons on a contractual basis during peak production periods.

Devine Entertainment trades on the Toronto Stock Exchange (DVN).







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# Letter to Shareholders

## DEAR FELLOW INVESTOR

Devine Entertainment's strategic vision that began in 1994 has remained unchanged. The Company will focus on increasing its library value by consistently building up its brand of high quality live-action children's and family programs.

During the past year, we delivered five new productions to Time-Warner's HBO Original Programming in New York. Our *Inventors' Specials*, a co-production with Ireland's Merlin Films, were also delivered to the Family Channel in Canada and sold to broadcasters in 50 foreign territories.

As a Canadian producer, Devine Entertainment is able to nurture the numerous bilateral co-production treaties that exist between Canada and many other countries. Our qualifications, under the terms and agreements of these treaties, enable the Company to access government incentives or investments in both our own country as well as in the co-producer's country. This gives Devine Entertainment the ability to broaden both its financing base as well as its talent pool. Our company is presently achieving an increase in interest from international co-producers due to our ever-widening experience in this area.

Since 1994, Devine Entertainment's founders and their talented teams have been working together to build the Company's international reputation. Our staff of eight strong at the head office in Toronto is the force behind the mechanics that make our films work so well. Added to this are our international co-producers in the Czech Republic, the Slovak Republic and Ireland who help us find locations and craftspeople from Prague to Venice and from Dublin to Toronto.

## EXPLOITING OUR LIBRARY

Devine Entertainment's further growth depends not only upon the continued worldwide distribution of our programs but also upon long-term revenue potential that can be generated through re-runs on television and by way of ancillary markets such as home video, music publishing, book publishing, CDs and cassettes, teacher's guides, and new media.

The international market continues to grow significantly. Privatization of former public channels and the emergence of new services is reaching sufficient critical mass which should generate higher license fees for new product and a continued demand for library product.

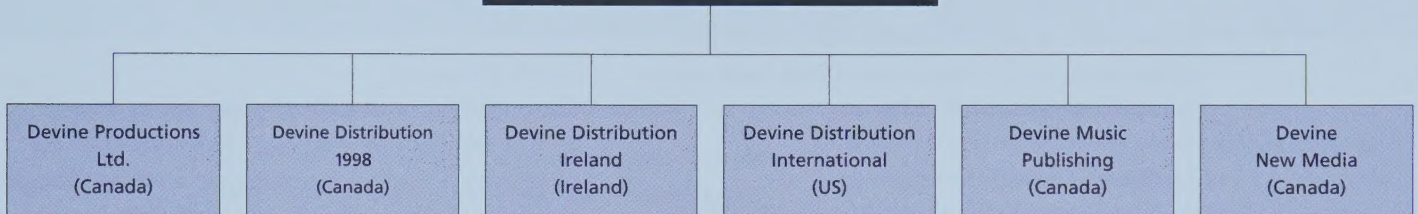
The demand for children's programming looks very favorable. Although sales have historically followed seasonal patterns based on viewership at Christmas, the emergence of dedicated children's cable channels around the world should create not only a continued demand for quality programming but also a market for ancillary goods like home video.







Devine Entertainment Corporation  
(Canada)



## ALWAYS LOOKING FORWARD

We are very proud of our many accomplishments in 1997 and are very excited about the year before us. In addition to completing the six episodes of *The Inventors' Specials* for HBO Original Programming, we are now commencing production on the six episodes of *The Artists' Specials* (also on HBO). This new series will continue to deliver the same high quality production values as our other award-winning films.

Whenever we produce a new program, our library grows and its value increases. With our popular programs, global audience reach, and talented creative and management teams, Devine Entertainment will continue to build long term value.

The advice of our Board is very helpful, and to all the members of our staff I wish to express genuine appreciation. I would further like to thank our co-production partners, broadcasters, and shareholders who support us and who have all contributed to our success.

Devine Entertainment's films will continue to come to life for families to enjoy worldwide and we will move forward to establish Devine Entertainment as the leader in children's and family live-action entertainment.

DAVID DEVINE

President & Chief Executive Officer  
April 30, 1998



# Program Library

## *A Young Children's Concert with Raffi & Raffi in Concert With the Rise and Shine Band*

These videos feature the acclaimed children's entertainer, Raffi, in concert. The program includes songs for singing, clapping and moving and an enthusiastic, active audience. Both videos have received numerous awards including the Parent's Choice Gold and Classic Awards and a Gemini Award. Since their release in the early 1980s, sales of both Raffi videos have been certified Multi-Platinum.

## *Beethoven Lives Upstairs*

Produced in 1992 as a broadcast special sold to Home Box Office in the U.S. and the Canadian Broadcasting Corporation (CBC), *Beethoven Lives Upstairs* became a phenomenal success. The film received worldwide critical acclaim and won a 1993 Primetime Emmy for outstanding children's program.

The program describes the relationship between a young boy and an eccentric boarder, Ludwig van Beethoven, who has moved in upstairs. At first the boy resents the new tenant, but slowly he comes to understand the genius of the man, the torment of his deafness and the beauty of his music. Set in 19th century Vienna, *Beethoven Lives Upstairs* is based on historical fact and features more than twenty-five excerpts of Beethoven's best-loved works.

## THE COMPOSERS' SPECIALS

These lush hour-long live-action films revolve around the relationship between a fictional child and a great classical composer, blending traditional storytelling and classical music to create innovative viewing for family audiences. Each story is grounded in the human relationship between child and composer, where the source of creative inspiration may be the loss of a friend, the fear of the family drifting apart, the grandeur of nature, the joy of performance or finding one's place in the world. The artists are accessible to the Company's target audience because the viewer sees them from a young person's perspective.

## *Bach's Fight For Freedom*

An independent young boy reluctantly becomes assistant to the frustrated composer Johann Sebastian Bach. The temperamental composer recognizes a kindred soul in the young boy. Set in 1717, *Bach's Fight for Freedom* passionately argues that the only master you can serve faithfully is your own heart.

## *Liszt's Rhapsody*

Franz Liszt takes on a young gypsy boy as a music student and finds his own work transformed by the experience. A simple wager turns into a mighty struggle of wills: a conflict of freedom vs. discipline, heart vs. brain, and passion vs. technique.

## *Rossini's Ghost*

A nine-year old girl witnesses Giacchino Rossini's efforts to salvage his seemingly cursed new opera. Set in 1816, the year *The Barber of Seville* had its disastrous premiere, *Rossini's Ghost* is the story of three women who learn that friendship, like opera, requires nurturing, patience, and time.

## *Strauss: The King of Three-Quarter Time*

A poor 10-year-old stableboy discovers how much he has in common with the great composer Johann Strauss Jr. The composer and the boy discover the healing bond of trust and embark on a collaboration that will be music to the world's ears.

## *Bizet's Dream*

A 12-year-old Parisian girl takes piano lessons from Georges Bizet as he anguishes over his life and his latest opera. Set in 1875, *Bizet's Dream* tells the compelling and bittersweet story of a special friendship.

## *Handel's Last Chance*

A Dublin street kid is selected as a choirboy for Georg Friedrich Handel's first performance of *The Messiah*. In the process, James is befriended by the renowned composer, who suffers from a temporary lack of self-esteem. When the boy is falsely accused of wrongdoing, Handel comes to his aid. *The Messiah's* premiere brings Handel glory and restores him to his rightful place in the musical world.





## THE INVENTORS' SPECIALS

In each film, a young protagonist befriends a genius and both are transformed. With the series, Devine hopes to “turn on” a new generation of young people to the often eccentric and yet always inspiring world of the great scientists and their inventions. Each of the films aims to illustrate that achievements in life, whether large or small, are usually the result of overcoming some sort of adversity.

### *Einstein: Light to the Power of 2*

An unlikely meeting of minds occurs in the U.S. of the 1950s when professor Albert Einstein comes to the rescue of an African-American girl. Nine-year-old Lannie is unmotivated, and her poor grades at school drive her struggling parents to despair. When Einstein's ideas about science ignite a spark in Lannie, she embarks on a voyage of self-discovery.

### *Leonardo: A Dream of Flight*

Set in Milan during the Renaissance, Leonardo da Vinci befriends young Roberto, son of a local bird seller. Leonardo's obligations as the Duke's court artist prevent him from pursuing work on a flying machine he's invented. Amidst political unrest and personal tragedy, young Roberto brings Leonardo a step closer to flight.

### *Galileo: On the Shoulders of Giants*

In Padua, at the dawn of the 17th century, the astronomer Galileo pits science against theological doctrine by demonstrating that the earth moves in space. In the face of Church persecution, the young Cosimo de Medici defends his tutor's ideas. Inspired by Galileo's quest for scientific truth, Cosimo vows to follow him on the road to discovery.

### *Newton: A Tale of Two Isaacs*

When his theory of gravity revolutionizes scientific thought in 1682, Isaac Newton pays a heavy price and is ostracized from the Royal Academy by his nemesis Robert Hooke. Isaac's young scribe Humphrey takes a universal, life-long lesson from Newton's struggle.

### *Marie Curie: More Than Meets the Eye*

During World War I, the two young Boudreau sisters decide to aid the war effort by catching spies. The strange comings and goings of Nobel Prize winning scientist Marie Curie make her a prime suspect. When Martine and Eliane follow Madame Curie to the battlefield, they discover that Curie is actually using science to save lives.

### *Edison: The Wizard of Light*

1893, West Orange, New Jersey... Thomas Edison – the world's greatest inventor – is alone in his lab, obsessed by a vision: “What if I could do for the eye what my favorite invention, the phonograph, does for the ear?” Jack, a scruffy young boy fleeing a truant officer, crashes into the lab. Edison makes the boy his apprentice and they embark on an adventure that eventually leads to the creation of the motion picture.



DEVINE'S LIBRARY OF FILMS							
	pre-1994	1994	1995	1996	1997	1998	1999
<b>Artists</b>							
Goya							★
Rembrandt							★
Michelangelo							★
Cassatt							★
Monet						★	
Degas						★	
<b>Inventors</b>							
Edison						★	
Newton					★		
Curie					★		
Galileo					★		
Leonardo					★		
Einstein					★		
<b>Composers</b>							
Rossini			★				
Handel			★				
Liszt			★				
Strauss			★				
Bach			★				
Bizet		★					
Beethoven Lives Upstairs	★						
Raffi 2	★						
Raffi 1	★						
<b>Totals</b>	<b>3</b>	<b>1</b>	<b>5</b>	<b>0</b>	<b>5</b>	<b>5</b>	<b>3</b>
<b>Library Total: 22 films</b>							



# Financial Report

## Management's discussion and analysis of financial condition and results of operations

### Fiscal 1997 Compared to Fiscal 1996

#### NET REVENUES

The Company's revenue for 1997 was \$3.4 million as compared to \$1.85 million for the year ended December 31, 1996, a year-over-year increase of 83%. Earnings before income taxes and expenses were \$0.15 per share with the Company's income before taxes and interest charges growing at a rate of approximately 24% to \$1,689,900 in 1997 as compared to \$1,357,072 in 1996. Earnings per share in 1997 were \$0.082, an increase of just over 9% from \$0.075 in 1996.

In keeping with the Company's strategy to focus on increasing the production of its own library of proprietary family programs, the Company completed the first five of a new six-episode series of one-hour films, entitled *The Inventors' Specials. Einstein: Light to the Power of 2, Leonardo da Vinci: A Dream of Flight, Galileo: On the Shoulders of Giants, Marie Curie: More Than Meets the Eye* and *Newton: A Tale of Two Isaacs* were delivered in 1997 to HBO in the U.S., The Family Channel in Canada and The Multimedia Group of Canada for international broadcast sales. The Company recognized production and distribution revenues of \$3.1 million on the delivery of these five new films in 1997.

Financial results in any period depend on the Company's production and delivery schedule of television programs. Broadcasters typically make most of their annual programming commitments in the first and second quarter of the year, so that the first new programs will be ready for delivery in the third and fourth quarter of the year. The Company recognizes revenue when the finished product is delivered and accepted by the customer. As a result, the Company's revenue is not recognized evenly throughout the year and a significant portion of such revenue is recognized in the fourth quarter. Consistent with the seasonal nature of the Company's business, the Company realized \$1.6 million in production and distribution revenue, or 47% of its total annual revenue, in the fourth quarter of 1997.

The Company's strategy is not only to focus on the production of its own programs to build its proprietary library of films and ancillary products, but also to produce programs with international appeal. In 1997 approximately 50% of the Company's revenues, or \$1.6 million, were derived from outside of Canada, as compared with 19%, or \$360,000, in 1996. This reflects the growing acceptance and awareness of the Company's films, specifically in the U.S., as well as the increased value a larger library of programs has in the international marketplace.

Overall Shareholders' Equity increased by 11% in 1997 to \$10.1 million from \$9.1 million in 1996 and the Company's asset base grew by \$3.8 million or 29%.

Amortization of the Company's program library is determined based on the ratio that current revenues earned from the programs bear to the management's estimate of total gross revenue to be realized. Revenue estimates involve uncertainties and accordingly are reviewed on a quarterly basis.

Operating expenses increased 13.4% to \$461,231 in 1997 as compared to \$406,625 in 1996, primarily due to an increase in the full-time staff in the Company's Toronto head office. This increase allows the company to bring some production and accounting activities in-house and thus creates increased efficiency.

In 1997 costs of productions sold totaled \$368,335, reflecting the cost of equity sales of *The Inventors' Specials* to The Maclean Hunter Television Fund, Shaw Children's Programming Initiative, and The Family Channel. These sales return an interest in the project's revenue stream of less than 4% to these parties after recoupment of their original investment. The Company benefits from broad-based strategic alliances with these broadcasters, cable and telecommunications companies, as well as from the direct value of the cash flow and investment provided by Maclean Hunter, Shaw Communications and The Family Channel.

#### **FISCAL 1996 COMPARED TO FISCAL 1995**

Revenue in fiscal 1996 totaled \$1.85 million as compared to \$7.1 million in 1995. This change reflects the one-time \$6,575,350 sale of the Company's series entitled *The Composers' Specials* in 1995. As a result of the tax-based financing concurrent with this sale, the Company received a cash benefit of over \$600,000, while retaining control of the revenue stream from the exploitation of *The Composers' Specials*. Revenues in 1996 included \$1.3 million in revenues from exploitation of the Company's library and government tax incentives.

The Company's income before taxes and interest in fiscal 1996 increased by over 46 times to \$1.35 million as compared to \$28,995 in fiscal 1995. Earnings per share increased to \$.075 in 1996 as compared to a loss of \$.001 in 1995.



## RISK FACTORS

The film and television production and distribution industry is competitive and involves risk. To reduce this risk, the Company continues its conservative approach to financing by ensuring that at least 80% of the costs of each project are secured before commencing production.

The Company has participated in and benefited from federal and provincial government production tax credit programs and other incentives in Canada and in Europe, which are subject to change in the future. To reduce this exposure the Company monitors foreign tax and film incentives and continues to produce its proprietary films under official co-production treaties with companies in European countries such as Ireland, Italy, and the Czech and Slovak Republics. In this way, the Company can benefit from European incentives and the reduced costs of location filming for its brand of historical period films.

The Company incurs expenses and licenses its television programs in currencies other than Canadian dollars. Foreign sales are customarily paid in U.S. dollars and production costs outside Canada are usually incurred in local currencies. As such, the Company may be affected by fluctuations in the exchange rates of the U.S. dollar and other foreign currencies. The Company reduces this risk by regularly reviewing the exchange rates of all the currencies that it expects to work with and will hedge through foreign exchange contracts in order to manage its foreign currency exposure where needed.

The Company's management has reviewed the possible risk associated with computers and the Year 2000. The Company has determined that all of its equipment and software is prepared for the Year 2000 date change. The Company expects that any date sensitive problem that might arise can be resolved at a minimum of cost that would be absorbed within ordinary operating budgets and without any interruption of the Company's business.

Devine Entertainment has an experienced senior management group, however it is substantially dependent upon the services of key individuals. The success of proprietary productions, acquisitions and expansion into related business areas depends on the skill and efforts of the Company's management.

**Devine Entertainment Corporation**  
**December 31, 1997 and 1996**

**Auditors' Report**

**To the shareholders of Devine Entertainment Corporation**

We have audited the consolidated balance sheets of DEVINE ENTERTAINMENT CORPORATION as at December 31, 1997 and 1996 and the consolidated statements of operations and retained earnings and cash flow for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 1997 and 1996 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles.

Toronto, Canada  
March 10, 1998



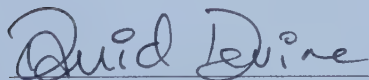
CHAPMAN, MATTEN, WELTON, FORSTER & WINTER  
Chartered Accountants



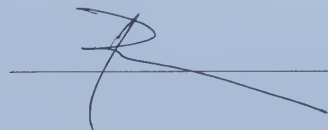
**Devine Entertainment Corporation**  
**Consolidated Balance Sheets**

	December 31	
	1997	1996
<b>Assets</b>		
Cash and term deposits	\$ 527,506	\$ 1,436,565
Accounts receivable	828,964	586,789
Notes receivable – notes 2(c) and 3	2,528,325	5,643,856
Investment in film, television programs and recordings – notes 2(d) and 4	9,873,819	280,096
Film and television programs in progress – note 2(e)	1,168,636	4,981,881
Deferred charges – note 2(f)	27,905	42,600
Furniture and equipment – notes 2(g) and 5	112,949	142,303
Film tax credit receivable – notes 2(i) and 4	1,866,000	-
	<u>\$ 16,934,104</u>	<u>\$ 13,114,090</u>
<b>Liabilities</b>		
Bank loans – note 6	\$ 3,830,825	\$ 427,731
Accounts payable and accrued liabilities	333,261	532,716
Income taxes	64,000	30,000
Loans and notes payable	-	489,695
Convertible debentures — note 7	585,811	709,822
Deferred revenue – note 2(b)	784,989	1,318,371
Deferred income taxes – note 2(j)	1,236,000	544,000
	<u>6,834,886</u>	<u>4,052,335</u>
<b>Shareholders' Equity</b>		
Capital stock – note 11	8,269,057	8,093,281
Share option – note 7	322,203	386,678
Retained earnings	1,507,958	581,796
	<u>10,099,218</u>	<u>9,061,755</u>
	<u>\$ 16,934,104</u>	<u>\$ 13,114,090</u>

Approved on behalf of the Board



Director



Director

The accompanying notes are an integral part of these statements.

**Devine Entertainment Corporation**  
**Consolidated Statements of Operations and Retained Earnings**

	Year ended December 31	
	1997	1996
<b>Revenue</b>	<b>\$ 3,405,556</b>	<b>\$ 1,857,774</b>
Costs of productions sold	368,335	-
Operating expenses	461,231	406,625
Amortization expense		
– film, television programs and recordings	844,538	47,439
– equipment	41,552	46,638
Interest expense	37,738	137,207
	<u>1,753,394</u>	<u>637,909</u>
<b>Income (before income taxes)</b>	<b>1,652,162</b>	<b>1,219,865</b>
Income taxes	<u>726,000</u>	<u>540,000</u>
<b>Net Income</b>	<b>926,162</b>	<b>679,865</b>
Opening retained earnings (deficit)	<u>581,796</u>	<u>(98,069)</u>
<b>Closing Retained Earnings</b>	<b>\$ 1,507,958</b>	<b>\$ 581,796</b>
<b>Net Income Per Common Share – note 12</b>	<b>\$ 0.082</b>	<b>\$ 0.075</b>

The accompanying notes are an integral part of these statements.



**Devine Entertainment Corporation**  
**Consolidated Statements of Cash Flow**

	Year ended December 31	
	1997	1996
<b>Cash Provided By (Used For)</b>		
<b>Operating Activities</b>		
Net income	\$ 926,162	\$ 679,865
Items not affecting cash:		
Amortization	886,090	94,077
Deferred income taxes	726,000	540,000
Net changes in other non-cash balances – Note 17	(9,466,045)	(4,395,598)
	<u>(6,927,793)</u>	<u>(3,081,656)</u>
<b>Financing Activities</b>		
Convertible debentures	(132,064)	100,000
Loans and notes payable	(489,695)	(1,434,352)
Bank loans	3,403,094	(744,077)
Issue of common shares	132,064	6,227,021
	<u>2,913,399</u>	<u>4,148,592</u>
<b>Investing Activities</b>		
Purchase of equipment	(12,196)	(137,404)
Notes receivable	3,117,531	111,259
	<u>3,105,335</u>	<u>(26,145)</u>
Increase (decrease) in cash	(909,059)	1,040,791
Cash and term deposits at beginning of year	1,436,565	395,774
Cash and term deposits at end of year	<u>\$ 527,506</u>	<u>\$ 1,436,565</u>

The accompanying notes are an integral part of these statements.

## **Devine Entertainment Corporation**

### **Notes to Consolidated Financial Statements**

**December 31, 1997 and 1996**

#### **1. Nature of business**

Devine Entertainment Corporation is an integrated developer and producer of high quality children's and family programs for worldwide television broadcast and home video markets.

#### **2. Significant accounting policies**

##### **(a) Basis of presentation**

These consolidated financial statements include the accounts of Devine Entertainment Corporation and its wholly-owned subsidiaries, Devine Productions Ltd., Devine Distributions Inc. and Devine Distribution Ireland. On October 31, 1997, Devine Productions Ltd. and Devine Distributions Inc. amalgamated to form Devine Productions Ltd.

##### **(b) Revenue recognition**

Revenue is derived from broadcast licensing agreements, government grants, royalties, distribution fees, the sale of equity in productions, and the sale of distribution rights. Revenue from broadcast licensing agreements is recognized once the licensing periods have commenced, the programs are delivered and collection is reasonably assured. Revenue from government grants, royalties and distribution fees is recognized when received. Revenue from the sale of equity in productions and the sale of distribution rights is recognized when the film or television programs are substantially complete and the investors have irrevocably committed to acquire the related equity or distribution rights and there is reasonable assurance of collectibility of proceeds.

Amounts received and not recognized as revenue are recorded as deferred revenue.

##### **(c) Notes receivable**

Notes receivable from tax shelter limited partnerships are initially recorded at cost. Their collectibility is dependent on the limited partnerships' share of the cash flow from the exploitation of the films. Management reviews these projected cash flows, evaluates the cost of the notes on a periodic basis, and follows a policy of writing down their carrying value when the projected cash flows do not support the recovery of the net carrying amount. These reviews are subjective in nature and involve uncertainties and matters of significant judgement.

##### **(d) Investment in film, television programs and recordings**

Investment in film, television programs and recordings represents the unamortized costs of film, television programs and recordings which have been produced by the company or for which the company has acquired a copyright interest or the rights to future revenue. Such costs include development and production expenditures, capitalized financing costs and other costs which are expected to benefit future periods.

Amortization is determined based on the ratio that current revenues earned from the programs bear to projected aggregate revenues. The investment is written down to the net recoverable amount if the carrying value is greater than the net recoverable amount. Net recoverable amount is defined as the total projected revenues to be earned from film, television programs and recordings, net of projected costs. The determination of the net recoverable amount is subjective in nature and involves uncertainties and matters of significant judgement.

##### **(e) Film and television programs in progress**

Film and television programs in progress represent the accumulated cost of incomplete film and television programs which are being produced by the company.



**(f) Deferred charges**

Financing costs are amortized on a straight-line basis over the terms of the debt obligations.

**(g) Furniture and equipment**

Equipment is recorded at cost less accumulated amortization. Amortization is provided using the diminishing balance method at an annual rate of 30% for computer and editing equipment, and 20% for furniture and fixtures.

**(h) Foreign currency translation**

Monetary assets and liabilities denominated in currencies other than Canadian dollars are translated at year end exchange rates. Revenue expenses and film production costs are translated at the rates prevailing at the times of the transactions. The gains or losses resulting from these translations are reflected in the statements of operations.

**(i) Government assistance**

The Company has access to government programs and tax incentives that are designed to assist film and television producers in Canada. Grants in respect of production assistance are recorded as revenue. Tax incentives which are based on film and television production costs are recorded as reductions of the related program costs.

**(j) Deferred income taxes**

Income taxes are accounted for on the tax allocation basis, under which the amount of income taxes payable for the year may differ from the total income tax provisions as a result of timing differences between the recording of amortization for accounting and income tax purposes. The tax effect of these differences is recorded as deferred income taxes.

**(k) Use of estimates**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates as additional information becomes available in the future. The assets which require management to make estimates and assumptions in determining their carrying values are primarily described in note 2(e) – Film and television programs in progress, note 3 – Notes receivable, and note 4 – Investment in film, television programs and recordings.

**3. Notes receivable**

	December 31	
	1997	1996
Non-interest bearing, due December 31, 1998. Interest at 11.255% per annum to June 30, 1996. Secured by a security interest in "The Composers' Specials" television programs	\$ 2,305,097	\$ 2,305,097
Non-interest bearing, due December 31, 1998. Interest at 11.255% per annum to August 31, 1996. Secured by a security interest in "The Composers' Specials" television programs	223,228	223,228
Interest bearing, at 10.375% per annum, due January 15, 1997	–	3,115,531
	<u>\$ 2,528,325</u>	<u>\$ 5,643,856</u>

#### 4. Investment in film, television programs and recordings

	December 31	
	1997	1996
Film, television programs and recordings	\$ 10,805,272	\$ 400,965
Less accumulated amortization	931,453	120,869
	<u>\$ 9,873,819</u>	<u>\$ 280,096</u>

The Company has reduced its investment in film and television programs by anticipated production tax credits in the amount of \$1,866,000. The Company also earns revenues from film and television programs which are not valued in the accounts.

#### 5. Furniture and equipment

	1997		1996	
	Cost	Accumulated Amortization	Cost	Accumulated Amortization
Computer and editing equipment	\$ 149,645	\$ 66,757	\$ 145,926	\$ 32,029
Furniture and fixtures	54,141	24,080	45,664	17,258
	<u>203,786</u>		<u>191,590</u>	
	90,837	\$ 90,837	49,287	\$ 49,287
	<u>\$ 112,949</u>		<u>\$ 142,303</u>	

#### 6. Bank loans

	December 31	
	1997	1996
Demand loan bearing interest at 2% above Royal Bank prime	\$ —	\$ 88,976
Term Loan bearing interest at 1.5% above Royal Bank prime, repayable in monthly payments of \$2,115 plus interest, secured by an editing computer system.	71,890	95,155
Term Loan, bearing interest at 6.75% per annum, repayable in monthly payments of \$4,200 plus interest, secured by a general security agreement, an assignment of insurance and guarantees by the officers of the company for \$30,000	193,200	243,600
Demand loans to a maximum of \$6,400,000, bearing interest at 1.5% above Royal Bank prime, secured by a first general security agreement, assignment, direction and acknowledgement agreements in respect of each of the license agreements, pecuniary loss indemnity, postponement of guarantors' claims, completion bond, assignment of all risk, errors and omissions insurance proceeds, assignment of Federal and Ontario Tax Credits, assignment of Mortgage of Distributor's Rights, assignment of copyright and any and all future revenue with respect to commercial exploitation of "The Inventors' Specials" television programs, and a security interest in all rights in and to "The Inventors' Specials" television programs	3,565,735	—
	<u>\$ 3,830,825</u>	<u>\$ 427,731</u>

Interest on the above term loans totalled \$20,590 (1996 – \$10,596)



## 7. Convertible debentures

	December 31	
	1997	1996
<b>Principal</b>		
Issued – December 1995	\$ 835,800	\$ 1,033,900
– February 1996	100,000	100,000
	<u>935,800</u>	<u>1,133,900</u>
Less – equity component	(322,203)	(386,678)
– unamortized equity component issue costs	<u>(27,786)</u>	<u>(37,400)</u>
	<u>\$ 585,811</u>	<u>\$ 709,822</u>

- (i) The Company issued 11,250 units of Debentures and Warrants in December 1995 for \$1,125,000 less costs of \$100,000, for net proceeds to the company of \$1,025,000. Each unit consists of a \$100 Debenture and 25 immediately separable Warrants.

The 7.5% Redeemable Convertible Subordinated Debentures mature on December 31, 2000, bear interest at an annual rate of 7.5% payable semi-annually, and are redeemable by the company upon 30 days written notice following any period of 20 consecutive trading days, ending not more than 5 trading days prior to the date on which notice of redemption is given, during which the weighted average market price of the company's common shares over such 20 day period equals or exceeds \$2.00, subject to adjustment in certain events. The Debentures are convertible at the holders' option into common shares at any time prior to maturity or, if called for redemption, on or before the last business day preceding the date specified for redemption, at a conversion rate of \$1.50 per share, being a rate of 67 common shares for each \$100 principal amount of Debenture, subject to adjustment in certain circumstances. The Debentures are subordinated to certain senior indebtedness of the company. Interest for the years ended December 31, 1997 and 1996 totalled \$70,455 and \$82,609 respectively. The annual interest requirement on the remaining Debentures is \$62,685.

During the year, \$198,100 of debentures were converted into 132,066 common shares. Assuming conversion of all remaining debentures, the maximum number of shares issuable is 559,986, equal to approximately 4.9% of the number shares currently outstanding (11,446,827).

- (ii) The Company issued a \$100,000 Redeemable Convertible Subordinated Debenture in February, 1996. This Debenture matures on December 31, 2000, bears interest at an annual rate of 7.5% payable semi-annually, and is redeemable by the company upon 30 days written notice following any period of 20 consecutive trading days, ending not more than 5 trading days prior to the date on which notice of redemption is given, during which the weighted average market price of the company's common shares over such 20 day period equals or exceeds \$2.00, subject to adjustment in certain events. The Debenture is convertible at the holder's option into common shares at any time prior to maturity or, if called for redemption, on or before the last business day preceding the date specified for redemption, at a conversion rate of \$1.50 per share, being a rate of 67 common shares for each \$100 principal amount of Debenture, subject to adjustment in certain circumstances. The Debenture is subordinated to certain senior indebtedness of the Company. The annual interest requirement on the Debenture is \$7,500. Assuming the conversion of the Debenture, the maximum number of shares issuable is 67,000.
- (iii) The fair value, at the time of issue of the Debentures, of the Company's obligation to make future payments of principal and interest, was \$766,850 (\$704,250 in 1995 and \$62,600 in 1996). The fair value of the holders' conversion options was \$458,150 (\$420,750 in 1995 and \$37,400 in 1996). The liability carries an effective interest rate of 20%.

## **8. Income taxes**

Income taxes have been provided for using the Company's combined federal and provincial statutory income tax rate of 44%.

## **9. Financial instruments**

Fair values approximate amounts at which financial instruments could be exchanged between willing parties, based on current markets for instruments of the same risk, principal and remaining maturities. Fair values are based on estimates using valuation techniques which are significantly affected by the assumptions used concerning the amount and timing of estimated future cash flows which reflect varying degrees of risk.

Therefore, due to the use of subjective judgement and uncertainties, the aggregate fair value amount should not be interpreted as being realizable in an immediate settlement of the instruments.

As at December 31, 1997 and 1996, the Company's financial instruments included cash and term deposits, accounts receivable, notes receivable, bank loans, accounts payable and accrued liabilities, loans and notes payable, and convertible debentures.

### **(i) Fair value**

The carrying values of cash and term deposits, accounts receivable, bank loans, accounts payable and accrued liabilities, and loans and notes payable approximate fair values because of their maturity and normal credit terms.

The fair value of the convertible debentures has been estimated by first calculating the present value of the liability component, and then assigning to the equity component the difference between the proceeds of the debenture and the fair value of the liability component.

The notes receivable arise from the sale of "The Composers' Specials" to a tax shelter limited partnership and, as such, fair market value information is not readily available. The determination of fair value is subjective in nature and involves uncertainties and matters of significant judgement. Management is of the opinion that the fair value approximates cost and that no adjustment to carrying value is required in the current year's financial statements.

### **(ii) Credit risk**

The Company's accounts and notes receivable are subject to credit risk. The Company continually monitors its positions with and credit quality of the organizations which are counterparty to its accounts receivable and does not anticipate non-performance. The notes receivable are secured by a security interest in "The Composers' Specials" television programs.

## **10. Commitment and Contingency**

The Company leases its premises at an annual rental of \$12,000 in addition to various occupancy costs under an agreement expiring May 31, 1999.

The Company has executed an outstanding Letter of Guarantee in the amount of \$150,000, which is payable in the event that certain equipment is not returned to Canada.



## 11. Capital stock

(a) Authorized - an unlimited number of common shares and Class A shares.

(b) Issued - common shares

	Number	Amount
Outstanding as at December 31, 1995	7,794,000	\$ 1,775,160
– Exercise of options for cash at \$0.50 per share	25,000	12,500
– Exercise of options for cash at \$1.50 per share	128,000	192,000
– Exercise of warrants for cash at \$2.00 per share	607,029	1,214,058
– Conversion of debentures at \$1.50 per share	60,732	91,100
– Public offering for cash at \$2.00 per share	2,700,000	5,400,000
Less issue costs	–	(591,537)
Outstanding as at December 31, 1996	11,314,761	8,093,281
– Conversion of debentures at \$1.50 per share	132,064	198,100
Less issue costs	–	(22,324)
Outstanding as at December 31, 1997	<u>11,446,827</u>	<u>\$ 8,269,057</u>

(c) Options and warrants

	Number of Shares	Share Exercise Price
Balance at December 31, 1995	1,262,750	
Issued during the year to an advisor	270,000	\$ 2.00
Exercised during the year	<u>(158,175)</u>	\$ 2.00
Balance at December 31, 1996	1,374,575	
Expired during the year	<u>434,575</u>	
Balance at December 31, 1997	<u>940,000</u>	

Options and share purchase warrants outstanding at December 31, 1997 are as follows:

Optionee	Expiry Date	Number of Shares	Share Exercise Price
Underwriter	October 3, 1998	270,000	\$ 2.00
Officers and directors	June 28, 1999	325,000	\$ 1.50
Officers and directors	June 28, 1999	325,000	\$ 1.75
Employees	February 17, 2001	<u>20,000</u>	\$ 1.50
		<u>940,000</u>	

## 12. Earnings per common share

Earnings per common share have been calculated using the weighted average number of participating shares outstanding during the relevant period. For the year ended December 31, 1997 the weighted average number of participating shares outstanding was 11,359,219 (1996 – 9,001,247). No material dilution of these per share amounts would result if all the outstanding options and warrants were exercised.

### 13. Related party transactions

The costs of film and television programs in progress include \$455,000 (1996 – \$485,000) for writing, direction and production services paid to a company controlled by two of the directors, representing the earned portion of a four year executive services contract, and \$132,500 (1996 – \$172,000) for production services paid to an officer. The Company believes that these amounts reflect prevailing market rates.

### 14. Government grants

The Company obtained \$501,712 (1996 – \$876,000) in government grants during the year which has been recorded as revenue.

### 15. Segmented Information

Revenue includes \$1,662,331 (1996 – \$360,001) derived from foreign sources.

### 16. Differences between Generally Accepted Accounting Principles (GAAP) in Canada and the United States (US)

The consolidated financial statements of the Company have been prepared in accordance with Canadian GAAP. The following adjustments and/or additional disclosures would be required in order to present the financial statements in accordance with US GAAP.

- (a) Under US GAAP, the Company would recognize deferred tax liabilities and assets at current tax rates, whereas under Canadian GAAP, timing differences are tax effected at the rates in effect when they arise. The Company has determined that **there would be no difference in measurement of income taxes between US and Canadian GAAP.**
- (b) Under US GAAP, primary earnings per share would be calculated using the weighted average number of common shares and common shares equivalents, as opposed to the weighted average number of common shares under Canadian GAAP. Options and warrants, however, which would normally be considered common stock equivalents under US GAAP, have an antidilutive effect on the calculation of earnings per share for each of the years presented and as a result, there is no difference between earnings per share figures under Canadian and US GAAP.

### 17. Net changes in other non-cash balances

	1997	1996
Decrease (increase) in accounts receivable	\$ (242,175)	\$ 549,680
Increase in film, television programs and recordings	(6,625,033)	(4,962,862)
Increase in film tax credit receivable	(1,866,000)	–
Decrease in accounts payable and accrued liabilities	(199,455)	(207,081)
Increase (decrease) in deferred revenue	(533,382)	224,665
	<u>\$ (9,466,045)</u>	<u>\$ (4,395,598)</u>



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**Corporate and Shareholder Information****Directors and Officers****David Devine**

Chairman of the Board

President & Chief Executive Officer

**Richard Mozer**

Vice-Chairman of the Board

Chief Financial Officer and Secretary

**Leif Bristow**

Senior Vice-President

**Kenneth Taylor**

Chairman, Government Business

Consulting Group

**William Ballard**

Chairman, BCL Entertainment Corp.

**Frank Baker**

Chairman, International Wallcoverings Inc.

**Bryson Farrill**

Financial Consultant

**Stock Exchange Listings**

**Toronto Stock Exchange, Ticker symbol – "DVN"**

**OTC – "DVNNF"**

**Registrar and Transfer Agent****Montreal Trust**

530 - 8th Avenue S.W., Calgary, AB T2P 3S8

**Legal Counsel**

Wildeboer Rand Thomson Apps & Dellelce

**Auditors**

Chapman, Matten, Welton, Forster & Winter

**Bankers**

Royal Bank of Canada

**Annual Meeting**

Tuesday June 23, 1998 at 4:15 p.m.

Cambridge Suites Hotel, Club Room

15 Richmond Street East

Toronto, Ontario



